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Bank recovery and resolution: Council confirms agreement with EP

The Permanent Representatives Committee today approved, on behalf of the Council, a compromise agreed provisionally with the European Parliament on a draft directive aimed at harmonising national rules on bank recovery and resolution (*17958/13*, *17957/13* + *COR 1* + *ADD 1*).

The directive will provide national authorities with common powers and instruments to pre-empt bank crises and to resolve any financial institution in an orderly manner in the event of failure, whilst preserving essential bank operations and minimising taxpayers' exposure to losses.

Today's agreement will enable the directive to be adopted by the Parliament and the Council at first reading,

The draft directive establishes a range of instruments to tackle potential bank crises at three stages: preparatory and preventative, early intervention, and resolution. Member states will be required, as a general rule, to set up *ex-ante* resolution funds to ensure that the resolution tools can be applied effectively.

Banks will have to draw up recovery plans, and update them annually, setting out the measures they would take to restore their financial position in the event of significant deterioration. Resolution authorities will have to prepare resolution plans for each bank, laying out the actions they might take if it were to meet the conditions for resolution.

Authorities will also have the power to appoint "temporary administrators" or special managers to an institution if its financial situation were to deteriorate significantly or if there were serious violations of the law.

P R E S S

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The main resolution measures would include:

– the sale of (part of a) business;

– establishment of a bridge institution (the temporary transfer of good bank assets to a publicly controlled entity);

– asset separation (the transfer of impaired assets to an asset management vehicle)

– bail-in measures (the imposition of losses, with an order of seniority, on shareholders and unsecured creditors).

Bail-in

Bail-in provisions, which enter into force in January 2016, will enable resolution authorities to write down or convert into equity the claims of the shareholders and creditors of banks that are failing or likely to fail. Certain types of liabilities will be permanently excluded from bail-in. A minimum level of losses equal to 8% of total liabilities including own funds will have to be imposed on an institution's shareholders and creditors before access can be granted to the resolution fund. Eligible deposits from natural persons and micro, small and medium-sized enterprises will have preference over the claims of ordinary unsecured, non-preferred creditors and depositors from large corporations. The deposit guarantee scheme, which will always step in for covered deposits (i.e. deposits below €100,000), will have a higher ranking than eligible deposits.

Exclusions from bail-in

Certain types of liabilities will be permanently excluded from bail-in:

– covered deposits;

– secured liabilities including covered bonds;

– liabilities to employees of failing institutions, such as fixed salary and pension benefits;

– commercial claims relating to goods and services critical for the daily functioning of the institution;

– liabilities arising from a participation in payment systems which have a remaining maturity of less than seven days;

– inter-bank liabilities with an original maturity of less than seven days.

National resolution authorities will also have the power to exclude, or partially exclude, liabilities on a discretionary basis for the following reasons:

(1) if they cannot be bailed in within a reasonable time;

(2) to ensure continuity of critical functions;

(3) to avoid contagion;

(4) to avoid value destruction that would raise losses borne by other creditors.

Resolution authorities will be able to compensate for the discretionary exclusion of some liabilities by passing these losses on to other creditors, as long as no creditor is worse off than under normal insolvency proceedings, or through a contribution by the resolution fund (see below).

<u>*Resolution fund*</u>

The directive requires member states, as a general rule, to set up *ex-ante* resolution funds to ensure that the resolution tools can be applied effectively. These national funds will have to reach, by 2025, a target level of at least 1% of covered deposits of all the credit institutions authorised in their country. To reach the target level, banks will have to make annual contributions based on their liabilities, excluding own funds and covered deposits, and adjusted for risk.

An exemption to this rule allows member states to establish their national financing arrangement through mandatory contributions without setting up a separate fund. However, the member states would have to raise at least the same amount of financing and make it available to their resolution authority immediately upon its request.

Resolution funds will be available to provide temporary support to banks under resolution via loans, guarantees, asset purchases, or capital for bridge banks. They can also be drawn on to compensate shareholders or creditors if and to the extent that their losses under bail-in exceed the losses they would have undergone under normal insolvency proceedings, in line with a "no creditor worse off" principle.

National resolution authorities could in exceptional cases exclude some liabilities and use the resolution fund to absorb losses or recapitalise a bank. However, such flexibility would only be available after a minimum level of losses equal to 8% of total liabilities including own funds has been imposed on an institution's shareholders and creditors, or under special circumstances 20% of an institution's risk-weighted assets where the resolution financing arrangement has at its disposal *ex-ante* contributions which amount to at least 3% of covered deposits.

The contribution of the resolution fund is capped at 5% of a bank's total liabilities. In extraordinary circumstances, where this limit has been reached, and after all unsecured, non-preferred liabilities other than eligible deposits have been bailed in, the resolution authority may seek funding from alternative financing sources.

Exceptional measures

The directive offers the possibility, under exceptional circumstances and subject to state aid rules, to temporarily inject capital into solvent banks that cannot access private funds. However, this precautionary measure is limited to injections necessary to address capital shortfalls revealed during stress tests, asset quality reviews or equivalent exercises conducted by the European Central Bank, the European Banking Authority (EBA) or national authorities.

Moreover, a stabilisation tool will allow for public capital injections in an emergency situation where an extensive bail-in of creditors could endanger financial stability. However, this would be subject to the 8% bail-in and conditional on approval by the Commission under state aid rules.

Minimum loss absorbing capacity

To ensure that banks always have sufficient loss-absorbing capacity, the directive provides for national resolution authorities to set minimum requirements for own funds and eligible liabilities (MREL) for each institution, based on its size, risk and business model. A review in 2016 will enable the Commission, based on recommendations by the EBA, to introduce a harmonised MREL applicable to all banks.